No. 14453

United States
COURT OF APPEALS
for the Ninth Circuit

CALDWELL FINANCE CO.,

Appellant,

vs.

SAMUEL A. McALLISTER, Trustee in Bankruptcy of the Estate of OSCAR HERMAN HERREID, Bankrupt,

Appellee.

BRIEF OF APPELLEE

Appeal from the United States District Court for the District of Oregon.

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Appeal from the United States District Court for the District of Oregon.

STATEMENT OF PLEADINGS AND FACTS UPON WHICH JURISDICTION IS BASED

On October 19, 1953, Oscar Herman Herreid was adjudicated a bankrupt and subsequently a trustee was appointed.

On said date, bankrupt was in possession of one 1950 and one 1951 International Pick-up truck (Tr. 3). Said Caldwell Finance Co. (hereinafter for brevity referred to as "Caldwell") seized possession on October 27, 1953, and after said date of bankruptcy (Tr. 4).

The Referee in Bankruptcy after show cause order directed to Caldwell ordered said trucks sold free and clear of liens, and subsequently declared the alleged claim of title or lien by Caldwell to be inferior to the title of the trustee in bankruptcy (Tr. 9).

Upon petition of Caldwell for review, the Referee certified the matter to the United States District Court for the District of Oregon for review, and upon review, the order of the Referee in Bankruptcy was affirmed (Tr. 15).

From the order of the District Court, Caldwell appeals (Tr. 16).

Jurisdiction of the Referee in Bankruptcy is based upon the Congressional Act of July 1, 1898, C. 541, Sect. 2, 30 Stat. 545 as Amended, Title 11 U.S.C.A. Sections 11 and 38.

Jurisdiction of the District Court is based upon the Congressional Act of July 1, 1898, C. 541, 39, 30 Stat. 555; June 22, 1938, C 275, § 1, 52 Stat. 858. Title 11, U.S.C.A., Section 67.

Jurisdiction of this Court is based upon the Congressional Act of July 1, 1898, C. 541, Sect. 24, 30 Stat. 553 as Amended, Title 11, U.S.C.A., Section 47.

STATEMENT OF THE CASE

Appellee believes it necessary in the interest of clarity to restate the facts, and the following are the pertinent facts as found by the Referee in Bankruptcy (Tr. 5-6) and adopted by the District Court (Tr. 15).

> "On November 5, 1952, the bankrupt executed and delivered to Caldwell a chattel mortgage for $2,600 upon a certain Mack Diesel tractor owned by the bankrupt and valued at $5,500. This mortgage was duly recorded. In June, 1953, the bankrupt paid Caldwell $100 plus accrued interest on the mortgage. In July, 1953, with the consent of Caldwell, the bankrupt traded the Mack tractor to the International Harvester Company for five used trucks.
>
> "Two trucks were sold immediately and $500 was paid to Caldwell Finance Company, leaving a balance owing of $2,000. To secure this balance, there was delivered to Caldwell the following documents:
>
> > '(1) Bills of sale executed by International Harvester Company conveying to the bankrupt and Caldwell Finance Co. the two International trucks and one Ford Flatbed truck. In each bill of sale the International Harvester Company warranted the title to be free from encumbrances "except a lien in favor of Caldwell Finance Co."
> >
> > '(2) The certificates of title on the three trucks with the name of the bankrupt as transferee inserted on the back of each certificate.
> >
> > '(3) A contract of conditional sale, which on its face was drawn between the International Harvester Company and the bankrupt. The bankrupt had signed this contract, but it was not executed by the International Har-

vester Company. This company refused to execute the contract or to assign it to Caldwell Finance Company. The three trucks were described in the printed form of conditional sale contract. Also inserted was the contract price of $2000, payable at the rate of $100 per month with interest at 10% per annum.'

"On August 5, the bankrupt sold the Ford Flatbed truck for $800 and turned the money over to Caldwell, leaving a balance owing Caldwell of $1,200. The applications for the transfer of the certificates of title on the two International trucks had not been signed by the bankrupt. Caldwell produced the two certificates at the first meeting of creditors and they were signed on the back by the bankrupt at that time to enable the trustee to proceed with the sale and transfer of the trucks."

CONTENTIONS OF THE PARTIES

Appellant contends that it held title to the vehicles in question by virtue of an alleged conditional sales contract, whereas appellee contends that the alleged conditional sales contract was not a conditional sales contract, but rather was in the nature of an unrecorded chattel mortgage to secure the balance due on a note previously executed by bankrupt to said appellant and hence was invalid as against appellee-trustee.

SUMMARY OF ARGUMENT

When Caldwell released the security from its chattel mortgage given for a prior loan and attempted to secure itself for the unpaid balance of said loan, it failed to se-

cure documents which would constitute a valid conditional sales contract in favor of itself, either in form or substance, or a valid recorded chattel mortgage upon said new security as required by the laws of Oregon, and hence had only a security device in the nature of an unrecorded chattel mortgage which device was invalid as against a trustee in bankruptcy who in Oregon occupies the status of a purchaser in good faith and for value.

ARGUMENT

Section 70c of the Bankruptcy Act, provides in part:

> "The trustee, as to all property whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

In Oregon the trustee is a purchaser in good faith and for a valuable consideration by virtue of ORS 29.150 which provides as follows:

> "From the date of the attachment, until it be discharged or the writ executed, the plaintiff, as against third persons, shall be deemed a purchaser in good faith and for a valuable consideration of the property attached, subject to the conditions prescribed in ORS 29.159 as to real property."

Therefore, in order for Caldwell to prevail as against appellee, it must show in itself such title to or lien upon

the vehicles as would prevail against a purchaser in good faith and for a valuable consideration.

Appellant has contended that it should prevail upon the theory that it had a valid conditional sales contract. Appellee contends that appellant has no valid conditional sales contract either in form or substance. Examining the documents in the light of appellee's contentions we find:

In Form

Among the documents upon which appellant relies is a conditional sales contract (Tr. 14). An inspection of this document shows that it is between the bankrupt and International (Tr. 14). Said contract has not been assigned to appellant and in fact, International refused to execute or assign said contract, which facts were found by the Referee and the District Court (Tr. 6).

In addition to said alleged conditional sales contract, there is a bill of sale (Tr. 10) wherein International sells and transfers said equipment to the bankrupt and Caldwell. The most that can be said of this document is that it transfers title to the vehicles to both the bankrupt and Caldwell. An inspection of the bill of sale discloses that International warranted title to be free of encumbrances "except a lien in favor of Caldwell Finance Co.", thereby evidencing that the inclusion of Caldwell upon the bill of sale was solely in recognition of Caldwell's security interest in the vehicles. Said bill of sale is of course between International on the one hand, and the bankrupt and Caldwell on the other, and not be-

tween the bankrupt on the one hand and Caldwell on the other. It does not purport to nor can it be construed to constitute a contract of conditional sale between Herreid and Caldwell.

The third set of documents involved consists of three certificates of title to the vehicles. As found by the referee, at the date of bankruptcy said certificates were endorsed by International in favor of the bankrupt as transferee and not in favor of Caldwell. There is nothing in these documents purporting to transfer title to Caldwell, and they certainly cannot be construed to be a conditional sales contract between Caldwell and the bankrupt.

It thus appears that the documents themselves show that they contain nothing in form at which Caldwell can point and say "there is a conditional sales contract."

But Caldwell argues that said documents constituted a conditional sales contract in substance.

In Substance

In determining whether the documents were even intended as a conditional sales contract, we should look behind them to the prior dealings of the parties. Upon doing so, we find that Caldwell is a finance company which held a chattel mortgage upon a truck belonging to the bankrupt. The bankrupt desired to trade said truck to International for the pickups which are the subject of this proceeding. Caldwell consented and, of course, desired to substitute the newly acquired pickups

as security for its debt in lieu of the released equipment. Caldwell was not a seller of equipment. There is no evidence that the trucks were ever in the possession of Caldwell.

As stated in the note in 138 A.L.R. 664:

> "A conditional sale contract contemplates a vendor and vendee, not a lender and borrower of money, and therefore an instrument, though in the form of a conditional sales agreement, which is executed for the purpose of securing the payment of a loan of money, will be treated as a chattel mortgage."

In the reported case, Hughbanks v. Gourley, 12 Wash. 2d 44, 120 P. 2d 523, the Court said:

> "This court has held that it is not the office of a conditional bill of sale to secure a loan of money. Its purpose, rather, is only to permit an owner of personal property to make a bona fide sale on credit, reserving title in himself, for security, until the purchase price is fully paid. Lyon v. Nourse, 104 Wash. 309, 176 P. 359. This particular security device, with its severe remedial incidents, is not favored in the law and its use has been restricted to situations where persons standing in the actual relation of vendor and vendee have desired to effect a credit sale. It is in such cases that it finds its only legitimate use.
>
> "Where, on the other hand, one who is the owner of a particular chattel wishes to borrow money and is willing to let the chattel stand as security for his debt, a chattel mortgage is the appropriate means for affording such protection to the creditor. And this is as true where the property mortgaged is purchased with the borrowed funds as where it has long been in the borrower's possession."

The Oregon court recognized this proposition in Kliks v. Courtemanche, 150 Or. 332, 43 P. 2d 913, when it stated on page 346:

> "We are unwilling to extend our conception of what may constitute a conditional sale contract to include the transaction between Phelps and the defendant culminating in the execution of the instrument of December 5, 1931. Conditional sale contracts are affected with secretiveness by nature, and their function can be much abused. They should not be employed to displace chattel mortgages which to afford protection to the mortgagee must be recorded."

In the Kliks case, the alleged conditional seller was in fact the seller. The facts of the case were: the defendant sold and delivered to the buyer on open account a mower. Some months later the seller obtained a title retaining note from buyer for $277.72 of which $105.00 represented the purchase price of the mower. The remainder of the note represented various items, including an open account and small deficiencies owing on other equipment previously sold to buyer.

The Oregon Court refused to hold that same was a valid conditional sales contract, but rather held that it was in the nature of a chattel mortgage and subject to the recording acts.

When the transaction between Caldwell and the bankrupt is examined in the light of these cases it appears obvious that the transaction fails in substance to measure up to a conditional sales contract. The transaction was one of security for a lender not of a seller—such a transaction calls for a chattel mortgage.

Answer of Appellee to Appellant Caldwell's Contentions

Appellant Caldwell has stated in its brief that whether the transaction between the parties constituted a chattel mortgage or conditional sales contract depends on the intention of the parties, and citing Kliks v. Courtemanche, 150 Or. 332, 43 P. 2d 913, states that such intention shall be ascertained from:

1. The conduct of the parties;

2. The attendant circumstances;

3. The terms of the agreement.

Appellant then looks at the conduct, circumstances, and terms of the agreement and concludes that the parties intended a conditional sales contract.

But, when we look at the conduct of the parties and attendant circumstances, what do we find that is inconsistent with an intention that Caldwell should have a chattel mortgage?

We find that Caldwell had a Chattel Mortgage for a past indebtedness and desired to release its security and take new security. In other words, Caldwell is a lender—not a seller, and the contract had its inception as a loan.

As stated by the Oregon Court in Bell v. Hanover Fire Insurance Company, 107 Or. 513, 519, 214 Pac. 340, 215 Pac. 171:

> "A well-established principle of law is that—
>
> 'When an absolute conveyance has been made upon an application for a loan, and an

agreement is made to reconvey upon payment of the money advanced, as a general rule the transaction is adjudged to constitute a mortgage. In each case the purpose of the grantor was in the beginning to borrow money; and unless a change be shown in his intentions, it is presumed that any use he may have made of his real estate in connection with it was merely as a pledge to secure a loan.

'The parties having originally met upon the footing of borrowing and lending, although a different consideration be recited in the deed, it will be considered a mortgage until it be shown that the parties afterward bargained for the property independently of the loan.' 1 Jones on Mortgages (7 ed.), § 266

"In the case at bar, the evidence establishes the relation of debtor and creditor, and not that of vendor and vendee. The plaintiff was neither buying nor selling automobile trucks. He was investing his funds in 'automobile paper.' "

Or as stated by the Oregon Court in A. G. Spalding Bros. v. Brown, et al., 36 Or. 160, 166, 59 Pac. 185:

"The primary inquiry may be said to be the intention of the parties, and this may be determined, not alone by the instrument which forms the basis of the transaction, but by the attendant and surrounding circumstances and the conditions under which it was delivered and designed to become effective. If it was the purpose of the parties to secure a previously existing debt, or one then created, or even to arise in the future, the irresistible inference would be that the transaction culminated in a mortgage; * * *"

The burden of proof was on Caldwell to establish that it had a conditional sales contract. See Kliks v. Courtemanche, supra at page 343. There is no evidence

that Caldwell had ever acquired possession of the vehicles, nor any evidence that it had ever surrendered or acquitted the prior promissory note supporting the prior mortgage.

The unpaid purchase price of the alleged conditional sales contract had no correlation to the sale price of the equipment, or its value. The amount due on the alleged conditional sales contract is in fact the amount of the already existing debt due from the bankrupt to Caldwell.

Looking at the instruments themselves, one cannot find any semblance of a conditional sales contract. Caldwell did not originally have title to said equipment and acquired only such title as it could acquire by virtue of the bills of sale; but at the same instant and by the same bill of sale, the bankrupt also acquired his title and without reservation. Furthermore the bill of sale itself plainly limited the interest of Caldwell to a lien (Tr. 10).

Caldwell knew that International had refused to assign the conditional sales contract and, therefore, that no conditional sales contract existed between itself and the bankrupt. Yet Caldwell failed to secure himself by obtaining a properly executed and recorded chattel mortgage.

It is true that Caldwell held the certificates of title, but even these were endorsed in favor of bankrupt, and bankrupt never endorsed said certificate (Tr. 5) and there is no evidence that Caldwell ever attempted to transfer said certificates to itself.

It should be noted here also that possession of the certificates of title, or even registration of same with the

Secretary of State is not a substitute for a recorded mortgage for as found by the Oregon Court, the registration act is purely a police measure. See Larison-Frees Co. v. Payne, 163 Or. 276, 298.

Appellee is unable to find any evidence among the facts and circumstances that a conditional sale rather than a chattel mortgage was intended, but in fact, believes that since what the parties intended was security for a past debt that in fact a chattel mortgage was intended.

Furthermore, appellee believes that under the law of Oregon as set out in the Kliks case, supra, since the purpose of the documents was to secure a non-seller for a past debt, that our Court would construe any instrument between the parties as a chattel mortgage even if the instrument were properly executed and drawn in the usual form of conditional sales contracts.

Caldwell argues that equity requires that the Court hold the instant transaction to be a conditional sales contract (Ap. Br. 12-14) and even that equity should regard that as done which ought to be done (Ap. Br. 11).

But in making such argument, appellant overlooks the clear mandate of Congress in the Bankruptcy Act wherein it vested a trustee with certain clear statutory rights and powers.

Section 70 c of the Act provides in part:

> "The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at

> the date of bankruptcy shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

The argument that equity should assist claimants in bankruptcy who failed to perfect their liens has often been made. Congress recognized this fact and in 1950, in connection with the preference sections of the Bankruptcy Act, stated its policy with regard to such arguments in Section 60a(6) of the Act as follows:

> "The recognition of equitable liens where available means of perfecting legal liens have not been employed is hereby declared to be contrary to the policy of this section. If a transfer is for security and if (A) applicable law requires a signed and delivered writing, or a delivery of possession, or a filing or recording, or other like overt action as a condition to its full validity against third persons other than a buyer in the ordinary course of trade claiming through or under the transferor and (B) such overt action has not been taken, and (C) such transfer results in the acquisition of only an equitable lien, then such transfer is not perfected within the meaning of paragraphs (2). Notwithstanding the first sentence of paragraphs (2), it shall not suffice to perfect a transfer which creates an equitable lien such as is described in the first sentence of paragraphs (6), that it is made for a valuable consideration and that both parties intend to perfect it and that they take action sufficient to effect a transfer as against liens by legal or equitable proceedings on a simple contract."

If this rule applies to preferees who have perfected their rights prior to bankruptcy, but within four months of bankruptcy, it should apply with greater force to

claimants such as Caldwell who at the date of bankruptcy have still not perfected their rights.

Therefore, if a creditor wishes to occupy as against the trustee a position as a secured creditor, it is incumbent upon such creditor to take whatever steps are required by the state law to create a valid legal lien. Caldwell has failed so to do because it failed to record a proper chattel mortgage upon said vehicles as required by ORS 86.350 and 86.370.

CONCLUSION

Thus it follows that, as the Referee in Bankruptcy and the District Court have both already held, Caldwell failed to obtain and record a valid chattel mortgage, and in fact, failed to secure any valid legal lien upon the vehicles and that, therefore, the trustee by virtue of said section 70 c of the Bankruptcy Act acquired title to said trucks free and clear of any claim of lien of said Caldwell, and, therefore, the Referee in Bankruptcy and the District Court should be affirmed.

Respectfully submitted,

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